

JUDGEMENT ENTERED ON MAY 14 1993

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

In Re:

ROBERT LAKE PRICE, and
LOU ANN PRICE,

Debtors.

Case No. 93-30052

Chapter 13

FILED
U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF NC

MAY 14 1993

J. BARON GROSHON

Deputy Clerk

ORDER DENYING DEBTORS' MOTION TO AVOID LIEN

This matter is before the court on the debtors' Motion to Avoid the Lien of Sears Roebuck and Company. The debtors claim that Sears violated provisions of the North Carolina Retail Installment Sales Act—"RISA") and as a consequence they are entitled to avoid Sears' lien. Sears argues that its procedures do not violate RISA and that even if they did, the remedies under RISA do not warrant avoidance of the lien in the present case. After a review of the pleadings and the appropriate case law the court has concluded that the debtors' motion to avoid Sears' lien should be denied.

FINDINGS OF FACT

1. Debtors Robert Lake Price and Lou Ann Price executed a "SearsCharge Security Agreement" with Sears Roebuck and Company in February, 1992. A copy of the SearsCharge Agreement is attached and incorporated herein by reference. Relevant portions of the SearsCharge Agreement are as follows:

SECURITY INTEREST IN GOODS. Sears has a security interest under the Uniform Commercial Code in all merchandise charged to the account. If I do not make payments as agreed, the security interest allows Sears to repossess only the merchandise which has not been paid in full... Any payments I make will first be used to pay any unpaid insurance or Finance Charge(s), and then to

pay for the earliest charges on the account. If more than one item is charged on the same date, my payment will apply first to the lowest priced item.

2. Under the SearsCharge Agreement the debtors were authorized to make purchases from Sears on a revolving charge account. The debtors had the option to pay the balance in full without incurring finance charges. If the debtors elected to make installment payments on the account, Sears imposed a finance charge of 18% per annum on the average daily balance.

3. On February 22, 1992 the debtors charged a video cassette recorder pursuant to the SearsCharge Agreement and signed the sales slip. The face of the sales slip signed by the debtors reads in part, "I grant Sears a security interest in this merchandise except in New York until paid in full."

4. On March 23, 1992 the debtors purchased a 5 h.p. tiller on their account, and signed a SearsCharge sales slip underneath identical language stating that Sears took a security interest in the goods purchased until paid in full.

5. Debtors made several payments on the account totalling \$349.

6. On January 12, 1993 the debtors filed their Chapter 13 bankruptcy petition.

7. On February 19, 1993 the debtors filed a motion to avoid the security interest taken by Sears in the items purchased on their SearsCharge account which is the subject of this Order.

STATEMENT OF THE ISSUE

The dispute involves the way Sears applies payments that it receives on its SearsCharge accounts. Sears credits payments first against unpaid insurance and finance charges and then applies the balance to items purchased on a first-in-first-out basis in accordance with the time each item was purchased. Debtors assert that G.S. § 25A-23(d) requires Sears to apply payments made by the debtors on their SearsCharge account on a pro rata basis to each item purchased, pursuant to a payment scheme set forth in G.S. § 25A-27; and that, because Sears' application of payments method is inconsistent with that scheme, that results in the automatic loss of Sears' purchase money security interest. The loss of Sears' purchase money status would then support the debtors' motion to avoid Sears' security interest pursuant to § 522(f) of the Bankruptcy Code as a nonpossessory, nonpurchase-money security interest. Sears contends that it is not subject to the payment scheme required by G.S. § 25A-27 and that even if it were, the penalties for a violation of RISA do not include loss of its purchase money security interest in these circumstances.

The court concludes that Sears has not violated the provisions of RISA which require application of payments on account on a pro rata basis. The application of payments rule is limited to transactions where the seller takes a security interest in previously purchased items to secure later purchases or where the seller and buyer agree to consolidate two or more consumer credit installment sale contracts. Neither of these two circumstances is

present in the case now before the court. Consequently, Sears has not lost its purchase money security interest and the debtors' motion to avoid the lien should be denied.

DISCUSSION

A. Statutory Scheme.

In order to determine whether Sears' liens and the application of payments thereunder run afoul of RISA, it is necessary to explore exactly which security agreements are controlled by the statutes. RISA was enacted in 1971 to address a number of abusive practices in consumer credit sales. N.C. Sess. Laws, 1971, c. 796, s.1. Pertinent to this discussion, it regulates the circumstances under which a seller may obtain a security interest pursuant to a revolving charge account contract. Under G.S. § 25A-23 a seller may take a security interest in:

- (1) The property sold, [and, among others]
- (2) Property previously sold by the seller to the buyer and in which the seller has an existing security interest.

N.C.G.S. § 25A-23(a).

In 1977 the North Carolina General Assembly enacted G.S. § 24-11(c) prohibiting the taking of a security interest in real or personal property pursuant to an open-end credit or similar plan that is subject to a monthly periodic rate greater than 1 1/4%. N.C. Sess. Laws, 1977, c. 917. The SearsCharge Agreement falls within this definition. However, that section specifically provides that "this subsection shall not apply to consumer credit sales regulated by Chapter 25A, the Retail Installment Sales Act." N.C.G.S. § 24-11(c). Thus, the proviso in G.S. § 24-11 eliminated

any possible conflict with G.S. § 25A-23. Nevertheless, three days after enacting G.S. § 24-11(c), the General Assembly amended G.S. § 25A-23 of RISA to include a new subsection (d) which sought to "clarify existing law." N.C. Sess. Laws 1977, c. 789, s.2. Subsection (d) clarifies that security interests are permissible in the case of revolving charge account contracts, notwithstanding provisions of G.S. § 24-11(a),¹ which were in arguable conflict with RISA, and further states, in pertinent part, "provided, however, the application of payments rule set out in G.S. § 25A-27 shall apply to such contracts." N.C.G.S. § 25A-23(d). The amendments were likely intended to cross reference each other and to remove any doubt as to their applicability. The reference to the application of payments rule in G.S. § 25A-23(d) was not intended to expand the rule. Rather, it could be the General Assembly's rationalization for excepting security interests regulated by RISA from the general prohibition of G.S. § 24-11(c). Although RISA allows a seller to take a security interest in property under a revolving credit contract, those security interests are subject to some limitations under G.S. § 25A-27.

Turning then to § 25A-27, RISA sets out a procedure for the application of payments received on account for the purpose of determining the amount of the debt secured by the various security

¹ G.S. § 24-11(c), not G.S. § 24-11(a), limits the taking of a security interest. The reference to G.S. § 24-11(a) instead of G.S. § 24-11(c) appears to be a technical error.

interests in the following situation:

- (a) Where a seller in a consumer credit sale makes a subsequent sale to a buyer and takes a security interest pursuant to G.S. 25A-23 in goods previously purchased by the buyer from the seller, the seller shall make application of payments received

N.C.G.S. § 25A-27(a) (emphasis added). The payment scheme set forth under G.S. § 25A-27(a) requires the seller to apply payments on a pro rata basis to the original cash prices of the merchandise. This procedure is specifically limited to the situation where the object of an earlier purchase serves as collateral for the debt of a later purchase. "Where a statute ... sets forth the instances of its application or coverage, other methods of coverage are necessarily excluded under the maxim *expressio unius est exclusio alterius*." Strong 12 N.C. Index 3rd, Statutes § 5.10, p. 75, citing Appeal of Bluebird Taxi Co., 237 N.C. 373, 75 S.E.2d 156 (1953). By limiting its application to situations in which a seller takes a security interest in goods previously purchased to secure the debt from subsequent sales, the legislature excluded from application of the statute those liens claimed in goods solely to secure the purchase price of the goods purchased. Subsection (b) of the same statute requires apportionment of payments to determine the amount of the debt secured by the various security interests in cases where the seller consolidates several existing installment sale contracts. N.C.G.S. § 25A-27(b). There is no suggestion that the debtors and Sears have consolidated any installment sale contracts and therefore G.S. § 25A-27(b) is not relevant to this discussion.

The RISA application of payments rule

takes aim at the practice of selling household goods to persons on credit and, when the payments have been made to the extent that there is a small balance, selling other articles upon condition that the previously sold goods as well as the newly sold goods are pledged as security repeated each time, [sic] the balance is reduced, *ad infinitum*. The effect of such a practice was that the buyer never really got out from under a security interest on all the property that he had ever bought from that seller regardless of the amount of the money that he paid.

Hafer, Eugene Clark, Richard S., Retail Installment Sales, Wake Forest L. Rev., Vol 8, No. 2, 177, March 1972. The application of payments rule was intended to address limited situations.

B. Statutory Application to Sears.

The relevant sections of RISA indicate that the application of payments rule of G.S. § 25A-27(a) is limited to those situations where the seller takes a security interest pursuant to G.S. § 25A-23(a)(2) for goods previously sold by the seller. Thus, security interests taken in "the property sold" pursuant to G.S. § 25A-23(a)(1) are not subject to the application of payments rule. N.C.G.S. § 25A-23(a)(1). The addition of G.S. § 25A-23(d) which provides that the application of payments rule applies to revolving charge account contracts did not expand the express language of G.S. § 25A-27(a) to include security interests taken only in the property sold.

Sears claims a security interest pursuant to G.S. § 25A-23(a)(1) -- in "the property sold," but Sears does not claim a security interest under section (a)(2) of the statute -- in "property previously sold by the seller to the buyer and in which

the seller has an existing security interest." N.C.G.S. § 25A-23(a)(1), (a)(2). The application of payments rule is limited to those situations where the seller takes a security interest pursuant to G.S. § 25A-23(a)(2) in goods previously sold by the seller. The SearsCharge agreement indicates that "Sears has a security interest under the Uniform Commercial Code in all merchandise charged to the account." That sentence is followed by language that limits the security interest to "only the merchandise which has not been paid in full." The sales slips incorporate the terms of the SearsCharge Agreement and grant Sears a security interest in "this merchandise." Neither the language in the SearsCharge Agreement nor the language in the individual sales slips seeks to, or is sufficient to, encumber previously purchased items as security for later purchases. Thus, Sears' practice of taking only a security interest in items purchased at the time the charge is made exempts those sales from the payments rule required G.S. § 25A-27.

The debtors contend that two things change this conclusion: first, that by applying the payments received first to any accrued interest and finance charges, Sears ultimately encumbers the previously purchased items with the finance charges of the later purchased items; and second, that the amendment to G.S. § 25A-23, adding subsection (d), was intended to subject all revolving charge accounts to the application of payments rule of G.S. § 25A-27. These arguments are without merit.

The debtors' arguments parallel a recent bankruptcy case, In

re Vandeusen, No. 92-00296-8-ATS (Bankr. Aug. 20, 1992), concerning the application of payments rule to revolving charge account contracts. In Vandeusen the court was faced with the same facts and issues as are present in the case now before this court. The debtors in Vandeusen executed a SearsCharge Security Agreement whereby they were authorized to purchase goods on their SearsCharge account and agreed to grant Sears a security interest in the goods purchased. The debtors purchased a washer and dryer on their account and granted Sears a security interest in the items pursuant to the SearsCharge Agreement and the sales slip which incorporated the terms of the Agreement. Later the debtors bought a window air conditioner on their account, and again, granted Sears a security interest in air conditioner. Debtors made payments on their account totaling \$666.00. Sears applied the payments first to discharge accrued finance charges and then to payment of principal on the first-in-first-out basis. The debtors filed a motion to avoid Sears' liens under § 522(f) of the Code for failing to apportion the \$666.00 payments in compliance with G.S. § 25A-27. Id. at slip op. p. 1-2.

The court concluded that Sears violated the provisions of RISA requiring Sears to apportion payments and therefore Sears lost its lien on the property. Sears argued that each purchase was an isolated purchase money transaction, unrelated to other purchases and therefore not subject to the application of payments rule. The court noted that "Sears' argument fails for two reasons: First, it ignores the fact that G.S. 25A-23(d) explicitly provides that the

application of payments rule shall apply to revolving charge accounts. Secondly, it is based on a myopic view of its Security Agreement." Id. at slip op. p. 5. The court did not specify whether G.S. § 25A-23(d) was intended to expand the limiting language of G.S. § 25A-27(a) restricting its application to accounts which seek to secure subsequent purchases with liens in previously purchased goods. The court did reason that Sears' practice of applying the payments first to all accrued finance charges amounted to taking a security interest in the previously purchased goods, the washer and dryer, to secure the finance charges from the subsequent sale, the air conditioner, thereby invoking the application of payments rule of G.S. § 25A-27. Id. at slip op. p. 6.

This court does not find the reasoning in Vandeusen persuasive for two reasons. First, as noted above, it is unclear whether the court in Vandeusen interpreted G.S. § 25A-23(d) as an expansion of G.S. § 25A-27 to all revolving charge account security interests. Irrespective of the position in Vandeusen, this court does not interpret G.S. § 25A-23(d) as an expansion of the application of payments rule. General Statute § 25A-23(d) was intended as a clarification of existing law and nothing in that section seeks to enlarge application of G.S. § 25A-27. Second, the court does not find that the application of the payments first to accrued finance charges is sufficient to invoke the application of payments rule. General Statute § 25A-27(a) is limited to those situations where the seller takes a security interest in previously purchased goods to

secure a later purchase; this is not Sears' practice. Each purchase is secured by only the goods then purchased and that security interest is extinguished upon the payment in full of that item. Admittedly, the payment of accrued finance charges may delay the eventual payoff of the previously purchased items, but the court does not consider this result the equivalent of taking a security interest in the previously purchased items.

The debtors referred to two other cases in North Carolina construing G.S. § 25A-27: In re Edge, (91-05055-5-ATS, Mar. 27, 1992) and Dossenbach's of Clinton v. Bartelt (In re Beasley), 23 B.R. 404 (Bankr. E.D.N.C. 1982). In re Edge is an unreported decision and does not deal with the issues in depth. In In re Edge the debtors filed a motion to avoid Sears' security interest in a treadmill claiming that Sears lost its purchase money status for failure to apportion payments as required by G.S. § 25A-27. The court found that Sears' first-in-first-out practice of applying payments violated G.S. § 25A-27 and resulted in the loss of its purchase money security interest. Id. at slip op. p. 2. In re Edge is a two page opinion and does not include a thorough articulation of the facts or the relevant law, consequently, this court's opinion is not influenced by the case.

Dossenbach's involved consolidation agreements whereby earlier debts and security were rolled into a new loan transaction upon subsequent purchases. The court found that the consolidation "contracts involved the sale of consumer goods to Debtors and the taking of security interests in goods previously purchased on

credit by Debtors from Creditor. Each of these sales involved precisely the situation N.C.Gen.Stat. § 25A-27(a)(3) was designed to govern." 23 B.R. at 406. Because the creditor failed to apportion payments as required by the statute, the creditor lost its purchase money security interest with respect to the previously purchased goods. Id. at 406-07. Dossenbach's is distinguishable from the present case because the creditor's practice of consolidation invoked the requirements of § 25A-27. Here, G.S. § 25A-27 is not applicable. Sears' security interest is not the product of a consolidation of previous purchases, nor does it seek to encumber previously purchased items to secure future purchases.

CONCLUSION

The issue before the court is whether the application of payments rule of G.S. § 25A-27(a) applies to the debtors' SearsCharge account to determine the amount of debt subject to Sears' various security interests; and if so, whether Sears has violated that rule such that it loses its purchase money security interest. The application of payments rule relevant to this discussion is limited to situations where the seller takes a security interest in goods previously sold to the buyer to secure subsequent sales. Sears has taken a security interest in the items purchased on the debtors' SearsCharge account. Each purchase is secured only by the items then purchased. Sears in no way attempts to take a security interest in any previously purchased items to secure future sales. Thus, Sears is not subject to the application of payments rule. Sears has adopted a method of apportionment of

payments that is both fair and beneficial to the debtors. Sears retains its purchase money status and therefore, its lien is not avoidable under § 522(f) of the Code.

It is therefore ORDERED that the debtors' Motion to Avoid the Lien of Sears Roebuck and Company is hereby DENIED.

This the 13th day of May, 1993.

George R. Hodges
George R. Hodges
United States Bankruptcy Judge

CERTIFIED TO BE A TRUE AND
CORRECT COPY OF THE ORIGINAL
U. S. BANKRUPTCY COURT

J. BARON GROSHON
WESTERN DISTRICT OF N. C.
BY: [Signature]

DEPUTY CLERK
DATE: 5/14/93